

# GENERAL FUND REVENUE UPDATE FISCAL 2005

A Report Prepared for the  
**Legislative Finance Committee**  
**Revenue and Transportation Committee**

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## **INTRODUCTION**

The purpose of this report is to provide the committees with more recent information on significant general fund revenue trends that are occurring in fiscal 2005. The 2007 biennium outlook table that traditionally is included in the report has not been updated. Instead, a summary table has been provided that shows the anticipated ending fund balance for fiscal 2005. The reason for not showing a 2007 biennium outlook table is because considerable research and analysis will be required to determine whether the revenue trends being observed in fiscal 2005 will be “one-time” or on going into the 2007 biennium. It should be noted that estimated payments for both corporation and individual income taxes that are due June 15<sup>th</sup> will not be completely processed until late June.

During the legislative session, our office testified to both the House and Senate Taxation committees about the revenue trends that were developing based on data through the end of January, February, and March of 2005. Even collection data by the end of January 2005 showed individual income tax collections could exceed the revenue estimate as adopted by the Revenue and Transportation Interim Committee on November 16, 2005. This report is based on information received through the end of May 2005.

The report is organized into three main sections. The first section discusses the fiscal 2005 general fund revenue outlook including a discussion of selected general fund revenue sources. The second section addresses significant economic trends that help explain or understand why selected revenue collections have changed from the House Joint Resolution 2 (HJR 2) estimates. The third section provides a summarization based on information received so far this fiscal year.

## **2005 GENERAL FUND REVENUE OUTLOOK**

### **FISCAL 2005 REVENUE TRENDS**

Based on information recorded through the end of May 2005 on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts for fiscal 2005 were \$1,192.4 million as shown in Figure 1. This compares to \$1,067.7 million collected for the same period of fiscal 2004. Total general fund collections are \$124.7 million above last year’s amount, which represents an 11.7 percent increase. Revised estimates as used by the 59<sup>th</sup> Legislature and contained in HJR 2 (revenue estimate resolution) adjusted for enacted legislation assumed collections would increase \$16.0 million or 1.2 percent from fiscal 2004 to 2005.

<p align="center"><b>Figure 1</b> <b>General Fund Revenue Status</b></p>							
Revenue Source	Actual Fiscal 2004	HJR 2 Estimate* Fiscal 2005	Through 5/31/2004	Through 5/31/2005	Difference	% Change	HJR2 Estimated % Change
GF0100 Drivers License Fee	3,021,405	2,958,000	2,578,134.77	2,997,650.03	419,515.26	16.2720%	-2.0985%
GF0200 Insurance Tax	56,532,929	59,272,000	41,854,095.31	43,688,278.31	1,834,183.00	<b>4.3823%</b>	4.8451%
GF0300 Investment Licenses	4,833,881	4,464,000	4,498,591.27	4,828,537.68	329,946.41	7.3344%	-7.6518%
GF0400 Vehicle License Fee	83,606,576	80,360,000	67,787,538.57	62,632,898.28	(5,154,640.29)	<b>-7.6041%</b>	-3.8832%
GF0500 Vehicle Registration Fee	30,723,879	31,730,000	24,848,819.51	24,127,537.09	(721,282.42)	<b>-2.9027%</b>	3.2747%
GF0600 Nursing Facilities Fee	5,915,840	5,855,000	4,399,813.01	4,408,157.27	8,344.26	0.1897%	-1.0284%
GF0700 Beer Tax	2,896,797	2,933,000	2,354,647.55	2,350,948.40	(3,699.15)	<b>-0.1571%</b>	1.2498%
GF0800 Cigarette Tax	36,001,502	34,608,000	31,955,744.00	31,612,310.88	(343,433.12)	-1.0747%	-3.8707%
GF0900 Coal Severance Tax	8,643,243	9,105,000	6,715,732.60	7,384,659.94	668,927.34	9.9606%	5.3424%
GF1000 Corporation Tax	67,722,940	66,332,000	48,508,960.44	74,265,415.65	25,756,455.21	53.0963%	-2.0539%
GF1100 Electrical Energy Tax	4,660,529	4,295,000	3,452,796.77	3,055,324.52	(397,472.25)	<b>-11.5116%</b>	-7.8431%
GF1150 Wholesale Energy Trans Tax	3,292,659	3,485,000	2,408,114.22	2,541,150.83	133,036.61	<b>5.5245%</b>	5.8415%
GF1200 Railroad Car Tax	1,567,868	1,585,000	1,526,754.02	1,414,679.81	(112,074.21)	<b>-7.3407%</b>	1.0927%
GF1300 Individual Income Tax	605,348,421	614,736,000	511,909,065.31	618,023,681.49	106,114,616.18	20.7292%	1.5508%
GF1400 Inheritance Tax	11,431,103	3,701,000	10,760,948.91	3,324,323.92	(7,436,624.99)	<b>-69.1075%</b>	-67.6234%
GF1500 Metal Mines Tax	3,231,871	4,483,000	1,737,645.95	2,537,074.58	799,428.63	46.0064%	38.7122%
GF1700 Oil Severance Tax	41,323,718	58,206,000	19,664,898.90	29,587,126.30	9,922,227.40	50.4565%	40.8537%
GF1800 Public Contractor's Tax	2,120,485	1,748,000	1,532,644.25	1,037,840.11	(494,804.14)	<b>-32.2843%</b>	-17.5660%
GF1850 Rental Car Sales Tax	2,485,989	2,593,000	1,864,863.08	1,854,595.05	(10,268.03)	<b>-0.5506%</b>	4.3046%
GF1900 1.5 VoTech Levy	967,988	912,000	581,706.67	522,153.98	(59,552.69)	<b>-10.2376%</b>	-5.7840%
GF2000 40 Statewide Levy	64,339,197	64,206,000	40,194,236.90	38,135,434.17	(2,058,802.73)	<b>-5.1221%</b>	-0.2070%
GF2100 55 Statewide Levy	104,223,809	104,252,000	62,702,090.86	59,960,468.60	(2,741,622.26)	<b>-4.3725%</b>	0.0270%
GF2150 Lodging Facilities Sales Tax	9,278,658	10,113,000	6,390,681.70	7,155,736.07	765,054.37	11.9714%	8.9921%
GF2200 Telephone Tax	28,634	0	22,346.07	31,657.37	9,311.30	41.6686%	-100.0000%
GF2250 Retail Telecom Excise Tax	20,890,335	21,307,000	15,029,408.11	13,739,262.09	(1,290,146.02)	<b>-8.5841%</b>	1.9945%
GF2300 Tobacco Tax	3,561,574	3,677,000	2,990,891.67	3,231,936.20	241,044.53	8.0593%	3.2409%
GF2400 Video Gaming Tax	50,748,949	52,932,000	37,458,219.94	39,844,964.10	2,386,744.16	6.3718%	4.3017%
GF2500 Wine Tax	1,423,463	1,436,000	1,180,145.05	1,279,222.86	99,077.81	8.3954%	0.8807%
GF2600 Institution Reimbursements	18,110,443	16,082,000	11,555,870.56	1,838,306.63	(9,717,563.93)	<b>-84.0920%</b>	-11.2004%
GF2650 Highway Patrol Fines	4,084,340	4,104,000	3,469,490.25	3,491,011.90	21,521.65	0.6203%	0.4814%
GF2700 TCA Interest Earnings	6,392,992	9,174,000	5,342,033.71	7,524,593.47	2,182,559.76	<b>40.8563%</b>	43.5009%
GF2900 Liquor Excise Tax	10,717,967	11,125,000	8,812,257.14	9,386,631.10	574,373.96	6.5179%	3.7977%
GF3000 Liquor Profits	6,500,000	6,608,000	0.00	0.00	0.00		1.6615%
GF3100 Coal Trust Interest Earnings	34,907,273	33,892,000	26,074,765.08	28,574,935.13	2,500,170.05	9.5885%	-2.9085%
GF3300 Lottery Profits	8,115,602	7,273,000	4,609,667.00	3,257,068.00	(1,352,599.00)	<b>-29.3427%</b>	-10.3825%
GF3450 Tobacco Settlement	2,933,928	2,871,000	2,933,928.09	2,977,777.37	43,849.28	1.4946%	-2.1448%
GF3500 U.S. Mineral Leasing	28,736,303	26,878,000	21,809,492.27	27,128,865.84	5,319,373.57	24.3902%	-6.4667%
GF3600 Other Revenue	30,241,562	28,304,000	26,138,860.47	22,634,753.37	(3,504,107.10)	<b>-13.4057%</b>	-6.4070%
Grand Total	\$1,381,564,648	\$1,397,595,000	\$1,067,655,899.98	\$1,192,386,968.39	\$124,731,068.41	11.6827%	1.1603%

\* Amended HJR2 plus legislation impacts.

This trend by itself indicates that general fund revenue growth for fiscal 2005 may be above expectations since total revenues were expected to increase by 1.2 percent from actual fiscal 2004 collections. If the current growth rate were to continue at the same level for the remainder of the year, the revenue estimate contained in HJR 2 would be exceeded by approximately \$145.4 million. Estimated collections for fiscal 2005 are from HJR 2 adjusted for impacts of legislation enacted during the 59<sup>th</sup> Legislature.

While the growth rate of 11.7 percent is above the adjusted HJR 2 estimated rate of 1.2 percent, there can be unusual events occurring between fiscal years that make an aggregate comparison of this type misleading. For example, if collection patterns during the past year are not similar to the current year, the computed growth rate can be skewed either positively or negatively. Unusual or one-time collections such as audit activity in either year can also distort the underlying growth rates. Both individual and corporation income tax collections can be significantly influenced by audit efforts of the Department of Revenue.

## DISCUSSION OF SELECTED REVENUE SOURCES FOR FISCAL 2005

As explained in the previous section of the report, a comparison of total revenues from the previous fiscal year to the current fiscal year can be misleading. Not only can collection patterns and statutory modifications change revenue trends, but changes in general economic conditions can also skew aggregate growth trends.

Figure 2

Comparison of Selected Revenue Sources to Adjusted HJR2 Estimates			
Revenue Source	Actual Fiscal 2004	HJR2 Estimated * Fiscal 2005	Estimated Chg From 2004
Cigarette Tax	36,001,502	34,608,000	(1,393,502)
Corporation Tax	67,722,940	66,332,000	(1,390,940)
Individual Income Tax	605,348,421	614,736,000	9,387,579
Inheritance Tax	11,431,103	3,701,000	(7,730,103)
Oil & Natural Gas Production Tax	41,323,718	58,206,000	16,882,282
TCA Interest Earnings	6,392,992	9,174,000	2,781,008
Coal Trust Interest Earnings	34,907,273	33,892,000	(1,015,273)
U.S. Mineral Leasing	28,736,303	26,878,000	(1,858,303)
All Other Sources	<u>549,700,396</u>	<u>550,068,000</u>	<u>367,604</u>
Totals	\$1,381,564,648	\$1,397,595,000	\$16,030,352

\* Amended HJR 2 plus legislation impacts.

commodity prices and greater production amounts. Interest rates, which determine anticipated earnings from short-term investments, (TCA interest earnings) are also expected to increase while capital gains from bond sales (coal trust interest earnings) in the trust funds bond pool are expected to decline. The reduction in inheritance taxes reflects the repeal of the state inheritance tax and the impacts of federal legislation on the estate tax. As shown in Figure 2, almost all the remaining general fund revenues were expected to remain relatively constant at the fiscal 2004 amount.

Figure 3

Potential Change From HJR2 Revenue Estimate	
Revenue Source	Millions Fiscal 2005
Individual Income Tax	\$78.4
Corporation Income Tax	<u>26.6</u>
<b>Totals</b>	<b>\$105.0</b>

The following section of the report addresses selected revenue sources whose estimated fiscal 2005 collections are anticipated to be different than estimated by the 59<sup>th</sup> Legislature. Also discussed are sources of revenue that our office is monitoring closely for potential differences in the collections versus the estimates adopted in HJR 2. Figure 3 shows the two major sources of revenue that are significantly exceeding HJR 2 estimates and the potential change between potential collections and HJR 2 estimates for fiscal 2005. The changes portrayed in Figure 3 are based on economic and accounting information received through May 2005.

### Individual Income Tax - \$78.4 million

Individual income tax collections for fiscal 2005 are expected to be \$78.4 million above estimates contained in HJR 2 adjusted for enacted legislation. Net collections (gross collections less refunds) through May 2005 were 20.7 percent above net collections through May 2004. The 59<sup>th</sup> Legislature assumed the growth rate to be 1.6 percent above the fiscal 2004 amount.

Unfortunately, it is not totally clear what is causing this unusually large surge in revenue collections. Since almost two-thirds of total income reported on state tax returns is from wage and salary income, a review of this income component may provide some insight. As shown in HJR 2, the wage and salary growth rate between calendar years 2003 and 2004 was assumed to be 5.7 percent (calendar 2005 data is unavailable). According to the Bureau of Economic Analysis (BEA) (shown in Figure 7), actual growth was 5.7 percent, exactly equal to the assumed rate shown in HJR 2.

Figure 4 shows the accounting details of individual income tax collections through May of this year compared to the same period of fiscal 2004. Withholding taxes, which should be an indicator of wage growth, have grown by 6.9 percent - higher than the growth in wage and salary income reported by the BEA. This may suggest that Montana's wage income is higher than reported by the BEA and/or over-withholding may be occurring and additional refunds will be issued next fiscal year.

Figure 4

Individual Income Tax Comparison				
Revenue Code & Description	Through 5/31/2004 Fiscal 2004	Through 05/31/05 Fiscal 2005	Difference	Percent Change
510101 Withholding Tax	413,892,001.12	442,257,501.13	28,365,500.01	6.85%
510102 Estimated Tax	123,456,742.11	166,210,567.09	42,753,824.98	34.63%
510103 Current Year I/T	97,062,500.73	139,105,743.40	42,043,242.67	43.32%
510105 Income Tax - Audit Collections	22,678,181.00	21,614,830.10	(1,063,350.90)	-4.69%
510106 Income Tax Refunds	(145,180,359.65)	(151,164,960.23)	(5,984,600.58)	4.12%
Totals	\$511,909,065.31	\$618,023,681.49	\$106,114,616.18	20.73%
Percent of Actual/Estimated	84.56%	100.53%		

Figure 4 also shows that estimated and current year payments are above last year's amount by 34.6 percent and 43.3 percent, respectively. Current year payments include about \$12.6 million that were re-categorized as audit collections during June. Estimated payments, and to some degree current year payments, reflect tax liability on non-wage components of income. Some examples of these components would be interest earnings, dividends, capital gains/losses, royalties, and net business income. Since estimated and current year payments are up significantly, then one or several of the non-wage components of income are above the estimates contained in HJR 2. Reported amounts on these components of income will not be available until late October 2005 when the Department of Revenue provides our office with data for tax year 2004.

Since the unanticipated increase in tax collections is so significant, it is unrealistic to assume that only one reason may be causing the surge in collections. The following is a list of potential explanations for the higher than anticipated individual income tax collections:

- Land and other real estate sales are producing large capital gains;
- Investors are cashing out of the equity market and taking capital gains;
- Oil and natural gas prices are at historic high levels. Royalty payments should be up significantly;
- Business profitability has improved since "9/11" and the recession. Net business income should be improving as reflected in higher corporation income tax collections;
- With higher corporate profits, more incentives and bonuses may be provided to employees. These items would not be reported as wage and salaries;
- Interest rates, especially for home mortgages, remain low. Mortgage refinancing reduces itemized deductions for interest expense and may increase tax liabilities;
- Reduced federal tax rates on dividends may have resulted in unusually high corporation dividend payments;
- Audit policies by the Department of Revenue are reaping the benefits of improved tax compliance.

### Corporation Income Tax - \$26.6 Million

Corporation income tax receipts for fiscal 2005 are expected to be \$26.6 million above estimates in HJR 2 adjusted for enacted legislation. Net collections (gross collections less refunds) through May of 2005 were 53.1 percent above the net collections through May 2004. The 59<sup>th</sup> Legislature assumed the growth rate to be a negative 1.4 percent below the fiscal 2004 amount. Figure 5 shows specific details of corporation income tax collections through May of this year compared to the same period of fiscal 2004.

Several circumstances explain most of the excess corporate income tax collections. First, the legislature assumed that there would be unusual large tax refunds, amounting to \$8.4 million, occurring in fiscal 2005. Those refunds, while

still anticipated to be issued in the future, have not occurred. Consequently, unusually high refunds expected in the current fiscal year could be paid in fiscal 2006 or subsequent years, reducing collections for that year. Our office will continue to monitor corporate income tax collections and notify the committees when those refunds do occur.

Second, corporation profits have improved dramatically since the recession of 2001 and the affects of “9/11”. As shown in Figure 8, the percent change in U.S. corporation profits for the past two quarters (Q4, 2004 and Q1, 2005) have exceeded 18 percent, cumulatively. Not only are multi-state corporations benefiting from higher profits, negative tax liability has diminished to the point where corporations are no longer filing refunds for carry backs of net operating losses. Furthermore, increased prices for oil and natural gas may be playing a role in higher than anticipated corporation income tax revenues. Detailed tax return data for tax year 2004 is currently not available to support this supposition.

Figure 5

Corporation Income Tax Comparison				
Revenue Code & Description	Through 5/31/2004 Fiscal 2004	Through 05/31/05 Fiscal 2005	Difference	Percent Change
510501 Corporation Tax	18,184,512.48	32,264,752.63	14,080,240.15	77.43%
510505 Corporation Tax Estimated Paym	36,242,722.15	50,181,038.81	13,938,316.66	38.46%
510502 Corporation Tax Refunds	(18,763,918.19)	(11,402,365.79)	7,361,552.40	-39.23%
510503 Corporation Tax-Audit Collect.	12,845,644.00	3,221,990.00	(9,623,654.00)	-74.92%
Totals	\$48,508,960.44	\$74,265,415.65	\$25,756,455.21	53.10%
Percent of Actual/Estimated	71.63%	111.96%		

## Oil & Gas Production Tax

At the end of May 2005, revenue from oil and natural gas production taxes was above fiscal 2004 collections by \$9.9 million or 50.5 percent. The 59<sup>th</sup> Legislature assumed revenue from this source would increase by 40.9 percent primarily due to higher price and production amounts for both commodities.

Based on data from the Energy Information Administration – June 2005, Montana’s oil price has increased from \$22.76 per barrel in calendar 2002 to \$38.53 per barrel in calendar 2004. For the first quarter of calendar 2005, Montana’s oil prices have averaged \$46.04 per barrel. Natural gas prices have increased by almost 12 percent from first quarter calendar 2004 to first quarter calendar 2005. If these prices prevail for the second quarter of calendar 2005, (assuming production equals HJR 2 estimates), total revenues from this source may exceed estimates by approximately \$2 million.

## Vehicle Fee and Tax

Motor vehicle revenue (both fees and taxes) is likely to be below the HJR 2 estimate for fiscal 2005. This is probably due to a reduction in the fees collected on semi trailers and “toy vehicles” (boats, snowmobiles, motorcycles, quadricycles, and off highway vehicles). The reason for this shortfall in fiscal year 2005 is due to legislation enacted during the 2003 legislative session that allowed these types of vehicles to obtain lifetime registrations beginning January 1, 2004. The lifetime fees, due in calendar 2004, were equal to one-half the amount that would be due in calendar 2005 and beyond. More than likely, many owners took advantage of this “half-price sale” with the consequence that fiscal 2005 revenue are below expectations.

## Property Tax

Property tax revenue (taxes from the assessment of the 95 mills) will probably be below the HJR 2 estimate for fiscal 2005 by as much as \$4 million. This estimate, however, is highly uncertain because a significant amount of the revenue is received by the state in June. In addition, a year-end accrual is processed in July that can fluctuate noticeably from year to year. For example, in fiscal 2004, the accrual entry was \$6.9 million while in fiscal 2003 it was \$10 million. Finally, the estimate for fiscal 2005 assumes a transfer from the general fund to a state special account of \$2.8 million. This transfer was authorized by SB 87 which required that half of accumulated protested

property taxes paid by centrally assessed properties be transferred to a state special account. The fiscal note for SB 87 showed this amount to be \$2.8 million, although the Department of Revenue has yet to calculate the final amount. Recent refunds of some centrally assessed protested taxes might reduce this amount below the estimate shown in the fiscal note.

### **TCA Interest Earnings**

Treasury cash account interest revenue is based on the amount of cash available to invest and the prevailing short-term interest rates. While both factors were projected to increase during fiscal 2005, cash balances in the account have increased above projections, exceeding \$500 million in April. Short-term interest rates, however, have not increased as projected. Data from the Board of Investments show the yield on the treasury cash account to-date for fiscal 2005 was 2.3 percent. This compares to the HJR 2 short-term interest rate assumption of 2.8 percent. With the combination of higher cash balances and reduced short-term interest rates, collections for fiscal 2005 are expected to be close to the estimate contained in HJR 2.

### **U.S. Mineral Leasing**

The surge in oil and natural gas prices increases the portion of federal royalties Montana receives from the production of these commodities on federal lands in the state. The increased revenues, due to higher prices, were anticipated by the 59<sup>th</sup> Legislature in HJR 2. Although this revenue source appears below expectations at the end of May 2005, three more months of revenue will be deposited before the close of fiscal 2005. Data from the federal Mineral Management Services indicate that with three more months of revenue collections, fiscal 2005 revenues will be approximately equal to the fiscal 2005 estimate.

It should be noted that with the enactment of SB 212 by the 59<sup>th</sup> Legislature, 75 percent of the revenue will be deposited to the general fund and 25 percent to the state special revenue fund. Although this change is reflected in the adjusted HJR 2 estimate, the change will actually occur in the closing period after the end of fiscal 2005. Up to that time, all the revenue is being deposited to the general fund.

## **SIGNIFICANT ECONOMIC TRENDS**

A strong economic climate in both Montana and the US has had a positive impact on the state's revenue collections. Montana revenues are sensitive to many factors such as wage and salary income, corporate profitability, prevailing interest rates, capital gains/losses, energy prices, and federal tax changes. The following is a brief summary of current relevant articles and reports that illustrate the impact of these economic factors on state revenues.

### **Montana Employment and Wages**

Statistics from the Montana Department of Labor and Industry (DLI) depict continued improvement in the labor market. Non-farm payroll employment was up 4,700 jobs in April 2005 (month over month) for an increase of 1.1 percent. Employment increases were observed in almost all industrial sectors.

Nationally, a Labor Department report showed employers added 78,000 jobs in May, down sharply from the 274,000 jobs added in April. This was the smallest monthly jobs gain since August 2003. Economists have mixed impressions on the slow job growth. While some point to the fact that the economy added an average of 15,500 jobs over the past six months, others see the weak growth as another sign that the economy is slowing. Wages increased 0.2 percent in May, meeting expectations for the period. (*Job Growth Weak*, CNNMoney, June 3, 2005).

Figure 6

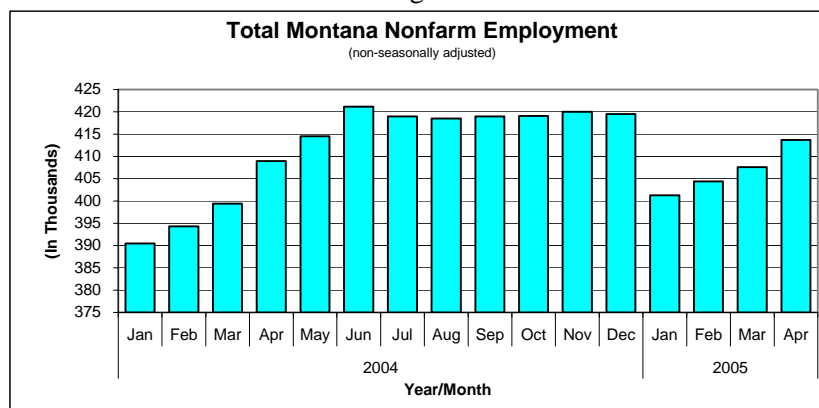
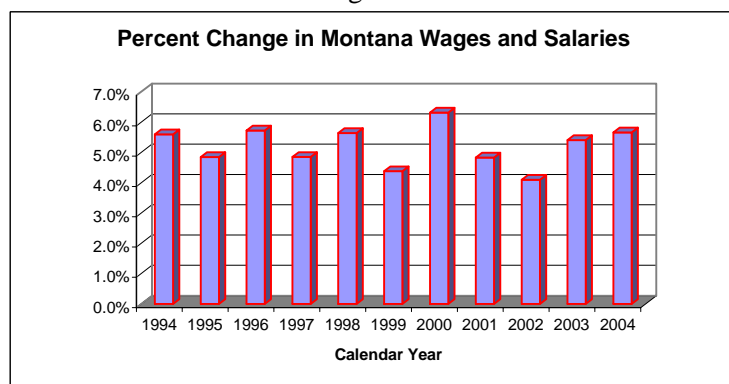


Figure 7



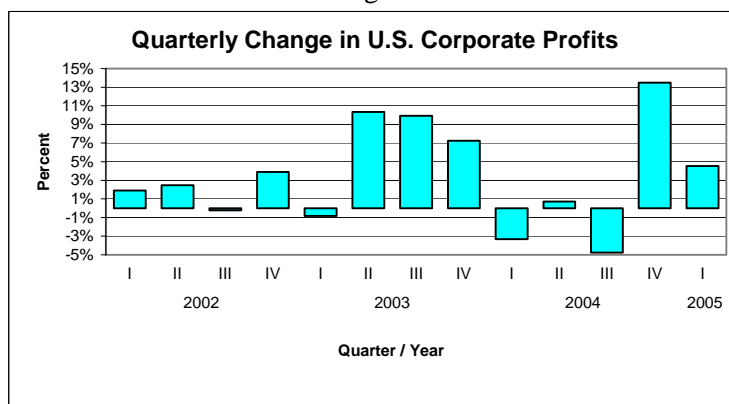
Montana wage and salary income continues to show strong growth trends, as anticipated in the HJR 2 estimates. According to the Bureau of Economic Analysis, the actual growth rate for calendar 2002 to 2003 was 5.2 percent while the growth rate from calendar 2003 to 2004 was 5.7 percent. It should be noted that although wage and salary income growth is consistent with HJR 2 estimates, individual income tax revenues continue to exceed expectations (see previous discussion).

## Corporate Profits

The Bureau of Economic Analysis estimates that US corporate profits increased 4.5 percent (at a quarterly rate) in the first quarter of calendar 2005 after increasing 14.5 percent in the fourth quarter of calendar 2004. Total profits of domestic corporations were more than 17 percent higher than a year earlier (*Corporate Profits Increase*, Bureau of Economic Analysis, May 26, 2005).

Montana's corporation income tax collections are now showing a strong correlation with national corporate profits. Both the collections of estimated payments and current year corporation tax collections are higher than was expected during the 2005 legislative session. The formidable growth in corporate profits suggests that the effects of the recession and "9/11" have subsided.

Figure 8

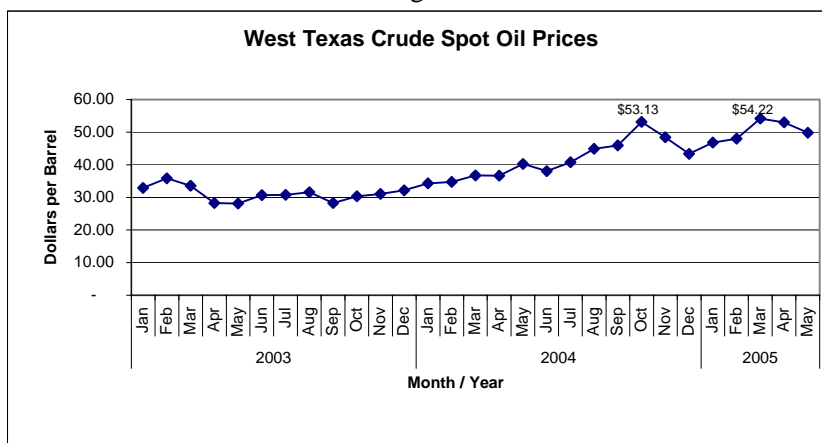




## Oil Prices

The spot price of West Texas Crude has hovered around \$50 per barrel since the beginning of 2005. The monthly average West Texas crude oil price has experienced steady increases since April 2003, reaching a high of \$54.22 per barrel in May of 2005. Overall, West Texas Crude spot prices have exceeded \$50 per barrel during the month of June, while July delivery prices rose 14 cents to \$52.68 a barrel. According to the Energy Information Administration, strong buying from customers in Asia for Middle Eastern crude oil and a substantial increase in U.S. refinery inputs provided renewed strength to crude oil markets. Another factor that may impact crude oil prices is the start of the Atlantic hurricane season on June 1, which can influence production on oil platforms in the Gulf of Mexico (*This Week in Petroleum*. EIA.doe.gov, June 8, 2005).

Figure 9



Prices of Montana crude oil remain higher than projected in HJR 2. The estimated per barrel price for fiscal 2005 was \$39.56 per barrel. The average West Texas spot price for crude oil between July 2004 and May 2005 has been \$48.05 per barrel. Montana oil prices are typically \$3 lower than West Texas prices, so the average price for that period may be \$45.05. Consequently, oil prices have been approximately 18 percent higher than projected for fiscal 2005.

## Interest Rates

The Free Open Market Committee (FOMC) is expected to again raise interest rates a quarter of a point when it meets later this June. The FOMC has increased rates eight times in the past year in the hopes of reducing inflationary pressures. While some economists believe that slow employment gains could play a role in halting the rate increases, Chairman Greenspan again ended recent remarks to lawmakers with a reference to the “measured” language the central bank used in its last policy statement regarding rate increases. Greenspan’s statements give rise to speculation that the FOMC will continue the policy of quarter-point interest rate hikes for the foreseeable future. (*Greenspan: Economy on ‘Firm Footing’*. CNNMoney, June 9, 2005).

Interest rates have a significant impact on all of Montana’s trusts and interest bearing accounts. While lower rates help to lower the cost of debt service on the state’s loans and bond issues, higher rates increase the revenues earned on many of the state’s financial instruments.

## SUMMARY AND FINANCIAL IMPLICATIONS

Based on data through the end of May 2005, total general fund revenue collections for fiscal 2005 have the potential to exceed HJR 2 revenue estimates by \$105.0 million. While the outlook for most revenue categories has not changed materially since the legislative session, the overall general fund revenue picture has improved substantially. The tax sources with significant increases above the HJR 2 estimates are individual and corporation income taxes. During June and the fiscal year end adjustment period (July 1 to July 22), significant revenue collections are recorded on the state’s accounting system. Both cash and accrual transactions recorded could change the potential excess revenue previously outlined in this report. A full report on the financial status of the general fund account for fiscal 2005 will be released in October.

As shown in Figure 10, the general fund ending fund balance for fiscal 2005 is projected to be \$162.4 million (*Legislative Fiscal Report, 2007 Biennium –June 2005*). This estimate is based on appropriations of the 58<sup>th</sup> and 59<sup>th</sup> Legislatures and includes the revenue estimates contained in HJR 2 adjusted for legislation impacts. Figure 10 also

shows the potential ending fund balance for fiscal 2005 including the revenue adjustments for individual and corporation income taxes. If these potential revenues materialize as projected, the general fund could end fiscal 2005 with a record high fund balance of \$267.4 million. As pointed out in earlier sections of the report, there are other sources of revenue that may be above or below the estimated amounts contained in HJR 2. Cumulatively, these other potential adjustments should be insignificant and have not been shown in Figure 10.

Figure 10

<b>General Fund Projected Ending Fund Balance</b>	
<b>LFD Fiscal Report vs. With New Revenue Information</b>	
	Fiscal 2005 Millions
<b>Projected Ending Fund Balance (Fiscal Report)</b>	<b>\$162.4</b>
<b>Potential Revenue Adjustments</b>	
Individual Income Tax	78.4
Corporation Income Tax	<u>26.6</u>
<b>Total Adjustments</b>	<b><u>105.0</u></b>
<b>Potential Ending Fund Balance (w New Rev. Info.)</b>	<b>\$267.4</b>

The obvious question this report generates is, “What does this information indicate for fiscal 2006 and beyond?” These trends portray a more optimistic outlook for the future, but a thorough analysis of the “permanent” versus “one-time-only” nature of these collections is imperative. Without this information, erroneous conclusions could easily be construed that may lead to inappropriate fiscal policy. For example, depending on the outcome of the Quality Schools Interim Committee, the December special session has the potential of increasing appropriations for public schools. If increases in public school funding is adopted by utilizing “one-time” revenue, eventually the funding for public schools or other state programs cannot be sustained. As recently reported in the Wall Street Journal – June 14, 2005; “State Budgets Get

Relief With Surge in Revenues” many states are experiencing greater revenue collections than anticipated. Some states, however, are spending the additional revenue. This may lead to a “boom and bust” cycle similar to the “dot com” bubble that was followed by a precipitous fall in the equity markets and ultimately a reduction in state revenues.

A thorough analysis of current revenue trends will be done during late summer and early fall in preparation for the revenue estimate process of the Revenue and Transportation Interim Committee. Ideally, your staff will be able to identify the reasons for the increases in individual and corporation income taxes and how much of this potential revenue will be on going during the 2007 biennium. While this is the goal, the committees should be aware that the detailed individual income tax return data for tax year 2004 will not be available until late October or early November. This means that staff will be required to do an exhaustive analysis of this information in a relative short period of time to meet the needs of the legislature for the December special session. As pointed out in the earlier discussion of individual income tax collections, there are several potential reasons why collections are exceeding expectations. There is always the possibility that the new data may not totally explain the current trends or data may not exist to quantify the “permanent” versus “one-time only” criteria. Your staff will be as diligent as possible to have the information you need for the December special session.